SIGMA FUNDS MANAGEMENT®

Sigma Australian Shares Strategy

Monthly update as at 28 February 2017

	Month %	Quarter %	1 year %	2 years % p.a.	3 years % p.a.	5 years % p.a.	Since Inception^ % p.a.
Sigma Australian Shares	0.2	5.7	32.8	2.7	5.6	11.2	4.9
S&P/ASX 200 Acc. Index	2.3	5.9	22.1	2.7	6.5	10.6	3.5
Value added (detracted)	**(2.1)**	**(0.2)**	**10.7**	**0.0**	**(0.9)**	**0.6**	**1.4**

**Gross Performance. Past performance is not a reliable indicator of future performance. ^Since Inception: 1st July 2007*

Key points

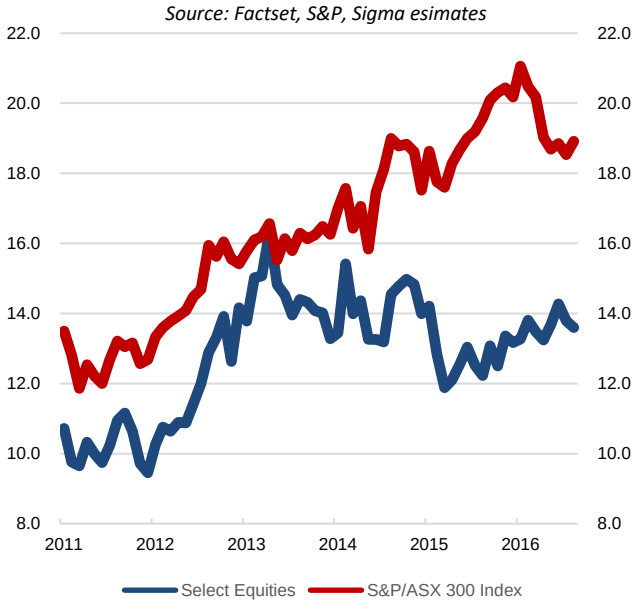
- Fund's cash levels increased to 10%, up from 4% twelve months ago due to market overvaluation
- Avoiding expensive safe havens that currently dominate that ASX200 Index
- Fund offers portfolio diversity, healthy cash generation, sustainable dividends & unpriced upside

Portfolio observations, changes and outlook

The Australian Share Fund (ASF) *underperformed* a rising market in February. Approximately 70% of the AEQ by market cap (excludes the four major banks and two major miners) is currently trading on a lofty PE multiple of near 19x (Figure 1). Historically, when equity markets have attained these levels, low to negative returns are ***near* certain.** Consequently, the Fund's cash levels are rising in line with market overvaluation.

Figure 1 - PE ex BHP, RIO & Major Banks: S&P/ASX 300 vs Select

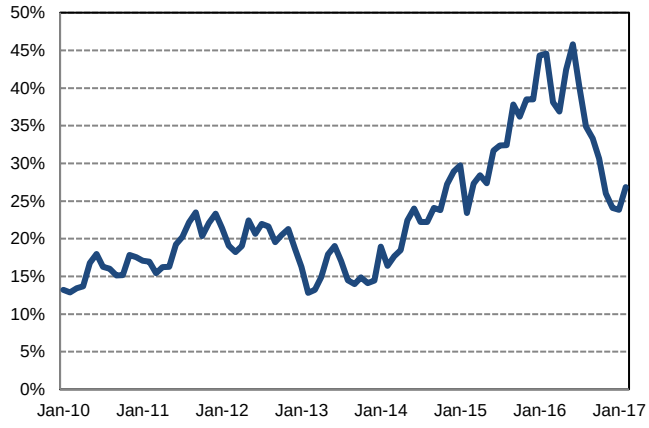
Source: Factset, S&P, Sigma esimates



Perversely, protecting hard earned capital in the current environment requires investors to embrace a more ***volatile portfolio* of businesses where *valuation support* is clearly evident**. Regardless of your views on risk, growth, quality, momentum etc., portfolios trading on high PE multiples have historically delivered low returns. Thus being true to our value label requires commitment to our *valuation disciplines*.

Figure 2- Australian Shares: Relative Valuation Upside

Source: Sigma Estimates, IRESS



Accordingly, ASF's s valuation metrics (Figure 2) remain supportive of delivering *positive returns* (+17% upside) in an overvalued market *(market has 10% downside overall)*, albeit we expect to have volatile outcomes over the short-to-medium term in line with recent experience.

Individual stock performance of note

Fund performance was driven positively by:

- IMF Bentham (+11%), stronger following an update to the market on its US business and a good result;
- McMillan Shakespeare (+18%) was higher post the result which also resolved the concerns around their Queensland contracts;
- Scrap metal supplier, Sims Metal Management (+12%) reported a solid result and a dividend well ahead of the markets expectations. The rally reversed the falls of the previous month where the scrap price outlook for the second half of the year weighed;
- Qantas Airways was stronger (+10%) after posting strong results and announcing the potential for further capital management at year end;
- The absence of index heavy weights Brambles (-11%) post a profit downgrade and Telstra (-4%) benefited performance in a relative sense.

Fund performance was negatively impacted by:

- Seven West Media (-15%) reported an inline result and outlook that was overshadowed by negative media press around the CEO's personal relationship with a former employee;
- Falls in the large diversified miners, BHP Billiton (-6%) and RIO Tinto (-5%). Strong results were overshadowed by near term profit taking after a substantial share price runs;
- Regional Banks, Bendigo and Adelaide Bank (-3%) and Bank of Queensland (-1%) were weaker on no real news. Bendigo reported a largely inline result with no surprises;
- The absence of Westpac (+6%) and Wesfarmers (+9%) detracted in a relative sense.

Stocks Added

None

Stocks Sold

None

Top 5 active positions

Stock	Active weight %
By Large Cap stocks:	
Bank of Queensland	4.5
Rio Tinto	4.5
BHP Billiton	4.3
ANZ Banking Group	4.2
National Australia Bank	4.0
By Small Cap stocks:	
Sims Metal Management	2.3
Nine Entertainment	1.3
Clydesdale Bank	1.1
Seven West Media	1.0
McMillan Shakespeare	0.8

Note: Active weights refer to positions above benchmark only.

Asset allocation

Sector	Active weight %
Materials	8.0
Consumer Discretionary	5.7
Financials ex-Real Estate	4.1
Consumer Staples	(0.1)
Information Technology	(1.1)
Energy	(1.9)
Utilities	(2.3)
Telecommunications	(2.5)
Industrials	(3.8)
Health Care	(6.5)
Real Estate	(8.4)
Cash & Other	8.8

Note: Active weights refer to positions above or below benchmark.

Strategy summary

Sigma Australian Shares is a concentrated 'Large-cap' strategy blending the highest conviction stock ideas from Sigma's Large Cap investment team, leading to:

- Superior outperformance,
- Lower risk, and
- Increased consistency.

Features of Sigma Australian Shares:

- High conviction value-biased portfolio of 15 to 30 stocks
- Focused primarily on the Top 100 stocks listed on the Australian Stock Exchange
- Return Objective of 4% over the benchmark over rolling 3-5 year periods

Benefits of Sigma Australian Shares investment approach:

- *Capital protection* is our first priority, and achieved through an absolute as well as relative valuation focus while maintaining a diversified portfolio of large Australian businesses;
- *Outperforming* by allocating capital to a focused portfolio of undervalued business that increase the probability of achieving the Return Objective.

About Sigma Funds Management

- Value-style Australian equities manager which aims to outperform without the downside of "value traps" through an investment approach called *Value: Risk Adjust*
- Sigma is an investment partnership, 51% owned by Aziumt, Itlay's leading independent asset manager with the Executive founders owning the remaining 49%

Contact

For more information contact Pinnacle Investment Management, the Fund's distributor, on 1300 010 311.

See also www.sigmafunds.com.au